FINANCIAL SERVICES/Conference, Passage

SUBJECT: **Conference report to accompany the Financial Services Modernization Act of 1999 . . . S. 900. Agreeing to the conference report.**

ACTION: CONFERENCE REPORT AGREED TO, 90-8

SYNOPSIS: The conference report to accompany S. 900, the Financial Services Modernization Act of 1999, will reform Depression-era laws and the Bank Holding Company Act in order to eliminate barriers that prevent banks, insurance companies, and securities firms from affiliating. It will create a new statutory framework for the financial services industry that will increase its safety and soundness and will give consumers more choices and lower prices. Key details are provided below.

- Regulatory authority. Banks, securities firms, and insurance companies will be allowed to affiliate either through a bank holding company structure (such holding companies may elect to be "financial holding companies" (see below)) or through financial subsidiaries. While the Federal Reserve Board will be the umbrella regulator of financial holding companies, functional regulation by the appropriate regulatory authorities will be established for insurance and securities affiliates or subsidiaries. The bill will establish a mechanism for coordination between the Federal Reserve and the Treasury Department regarding the approval of new financial activities for both financial holding companies and national bank financial subsidiaries.
- Financial Holding Companies (FHCs; FHCs are a new type of entity that will be created by this Act). FHCs will be permitted to engage in activities that are financial in nature or incidental to financial activities, or activities that are complementary to financial activities and that do not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally. Permissible activities for FHCs will include insurance and securities underwriting and merchant banking (with certain limitations). FHCs will be able to engage in permissible activities without gaining prior approval from the Federal Reserve but will have to submit a notification to the Federal Reserve within 30 days of commencing an activity. The determination of whether activities that are not specifically listed in this Act as financial in nature or incidental to financial activities will be made by the Federal Reserve in coordination with the Treasury Department. A determination on complementary activities will be made by the Federal Reserve by

(See other side)

YEAS (90)

Republican (52 or 98%)		Democrats (38 or 84%)	
Abraham	Helms	Akaka	Kerrey
Allard	Hutchinson	Baucus	Kerry
Ashcroft	Hutchison	Bayh	Kohl
Bennett	Inhofe	Biden	Landrieu
Bond	Jeffords	Bingaman	Lautenberg
Brownback	Kyl	Breaux	Leahy
Bunning	Lott	Byrd	Levin
Burns	Lugar	Cleland	Lieberman
Campbell	Mack	Conrad	Lincoln
Chafee, Lincoln	McConnell	Daschle	Moynihan
Cochran	Murkowski	Dodd	Murray
Collins	Nickles	Durbin	Reed
Coverdell	Roberts	Edwards	Reid
Craig	Roth	Feinstein	Robb
Crapo	Santorum	Graham	Rockefeller
DeWine	Sessions	Hollings	Sarbanes
Domenici	Smith, Bob	Inouye	Schumer
Enzi	Smith, Gordon	Johnson	Torricelli
Frist	Snowe	Kennedy	Wyden
Gorton	Specter		
Gramm	Stevens		
Grams	Thomas		
Grassley	Thompson		
Gregg	Thurmond		
Hagel	Voinovich		
Hatch	Warner		

NAYS (8)

Republicans (1 or 2%)	Democrats (7 or 16%)
Shelby	Boxer
	Bryan
	Dorgan
	Feingold
	Harkin
	Mikulski
	Wellstone

NOT VOTING (1)

Republicans (1)	Democrats (0)
McCain-[2]	

VOTING PRESENT (1)
Fitzgerald

EXPLANATION OF ABSENCE:
1—Official Business
2—Necessarily Absent
3—Illness
4—Other

SYMBOLS:
AY—Announced Yea
AN—Announced Nay
PY—Paired Yea
PN—Paired Nay

regulation or order. All depository institution affiliates of bank holding companies electing to become FHCs will have to be well capitalized and well managed.

- Financial subsidiaries (financial subsidiaries are a new type of entity that will be created by this Act). National banks and insured State banks will be permitted to engage in activities that are financial in nature or incidental to a financial activity through "financial" subsidiaries. Generally, national banks and Federal Reserve System member banks will be prohibited from engaging in merchant banking, insurance underwriting, real estate development, and real estate investment. The restriction on merchant banking may sunset in 5 years, if the Treasury Department and the Federal Reserve agree. Generally, a bank with financial subsidiaries: will have to be well capitalized and well managed; will only be permitted to invest in all of its financial subsidiaries an amount that is the lesser of 45 percent of its consolidated total assets or $50 billion; will have to have one of the three highest ratings for eligible unsecured debt (generally the last debt to be paid) if it is among the 50 largest insured banks in the United States; and will have to meet a rating requirement devised by the Federal Reserve and Treasury Department if it is among the 51st to the 100th largest banks. Except for specifically excluded activities, financial subsidiaries will be permitted to engage in the same activities approved for FHCs. Permissible activities for financial subsidiaries also may be determined by the Treasury Department in coordination with the Federal Reserve. To prevent double counting of assets, a bank will be required to deduct from its capital its equity investment in its financial subsidiaries, including retained earnings.

- Community Reinvestment Act (CRA) background. Under the 1977 law, Federal banking regulators are required to consider how a bank has been meeting local credit needs when it applies to open a new branch, merge with another bank, or otherwise expand ite Units70.117ubsng reguetsh o rg has6-7(been)-6(25(eeting)9(local c5 y)22(ed. nk)10)26(m)-6(als)-6(o m)denine6(ets)-6'001 activl9.812(s)

the affiliations permitted by this Act. States will be prohibited from preventing or significantly interfering with the ability of banks and their affiliates from engaging in insurance sales activities. There will be 13 "safe harbors" (State laws related to insurance sales protected from Federal preemption). In litigation between State insurance regulators and the Comptroller of the Currency, the Comptroller will not receive deference if the subject State insurance sales law was adopted after September 3, 1998. State insurance sales laws (other than the 13 safe harbors) adopted after September 3, 1998 will be subject to this Act's nondiscrimination standards.

- Unitary thrifts. The chartering of de novo unitary thrift holding companies with traditional unitary thrift holding company powers will be prohibited effective May 4, 1999. Existing unitary thrift holding companies and such companies authorized pursuant to applications filed before May 4, 1999 will be grandfathered.
- Federal Home Loan Bank (FHLB) System Modernization. FHLB membership will be made voluntary for thrifts. Banks with less than $500 million in assets will be permitted to pledge small business and agricultural loans as collateral and to use the advances to fund small business, small farm, and small agribusiness lending. A risk-based capital system will be established.
- Automatic Teller Machine (ATM) fee disclosure. ATM fees will have to be disclosed at host ATMs, and consumers will have to be informed of possible fees when they are issued ATM cards.

Those favoring passage contended:

The efficient delivery of financial services in the United States is being hampered by outmoded barriers that separate the banking, insurance, and securities fields. To a large extent, those barriers have already been weakened as businesses have worked to find creative means around them. We applaud the market forces that have led to the weakening of those barriers because they have given consumers more and better products at lower prices, but we note that they have also led to a degree of instability and uncertainty as to what the rules really are. This bill will remove the uncertainty by knocking down what is left of these crumbling financial Berlin Walls and setting up a level playing field on which banks, securities firms, and insurance companies can compete. Basic regulatory structures will be kept for each industry, existing regulatory agencies will regulate the same functions they currently regulate, and insured deposits will be protected with strict capitalization standards.

The three largest issues that had to be resolved by conferees were on the structure for affiliations, the CRA, and consumer privacy. On the first issue, some Members favored a holding company structure under the umbrella supervision of the Federal Reserve; other Senators wanted there to be at least the option of having an operating subsidiary structure under the regulatory supervision of the Treasury Department. Proponents of the first position were fearful of politicizing banking policy by giving new regulatory authority to the Treasury Department; proponents of the second position wanted to ensure that medium-sized banks would not be put at a competitive disadvantage with larger banks that already had formed holding companies and which had greater economies of scale that could better absorb the costs of having holding companies. This bill contains compromise language that has been endorsed by both the Federal Reserve and the Treasury Department. On the CRA, some Members favored expanding it and applying it to holding companies and financial subsidiaries; other Senators favored putting restrictions on the current CRA. Again, both sides have compromised in this conference report. Sunshine provisions will be enacted, and regulatory relief will be provided for smaller banks. Also, an election of a bank holding company to become an FHC will not be effective if the Federal Reserve finds that as of the date of the election not all of the subsidiary insured depository institutions of the holding company had received a "satisfactory" or better CRA rating at their most recent CRA examinations, and the appropriate Federal banking agency will prohibit an FHC, or a bank through a financial subsidiary, from commencing any new financial activities (whether by acquisition or merger) in the event that the bank or any of its insured depository institution affiliates or any insured depository institution affiliate of the FHC failed to have at least a "satisfactory" CRA rating at the time of its last examination. On the final main area of controversy, consumer privacy, the main reform provision will subject "financial institutions" to notice and opt-out provisions.

S. 900 is easily the most significant financial reform bill of the past 60 years and is easily one of the major bills of this century. The need, in general, for the sweeping reforms that it contains has been broadly recognized for some time, but it has been extremely difficult to get all of the competing interests to agree to the form the bill should take. Concerted efforts to pass this bill have been underway for more than 20 years; we are pleased that those efforts, finally, are about to succeed.

Those opposing final passage contended:

Argument 1:

Though we are in a distinct minority, we strongly favor having barriers between banks, insurance companies, and securities firms. Those barriers prevent the consolidation of financial assets and provide protection for Americans from the formation of huge, anti-competitive companies. The mixing of banks, which have insured deposits, with types of businesses that are inherently more risky is an especially dangerous proposal. The Great Depression occurred largely because of this type of mixing of financial services. When one sector failed, it dragged down the others with it. More recently, in the Asian financial crisis, we have seen that anti-

competitive, sweetheart deals result when banks, insurance, securities, and commercial businesses are allowed to mix, and those deals eventually cause economic meltdowns. We have our own history of 60 years ago to warn us, and the recent Asian financial crisis to remind us, that there is good reason to prevent this type of economic concentration. This bill and any other bill that would remove existing barriers should be defeated.

Argument 2:

Our primary objection is to the invasion of personal privacy that this bill will permit. Advances in database computing have put very detailed, very personal information at the fingertips of almost anyone who may wish to start prying. Financial records, buying patterns, medical records, educational achievement, driving records, arrest records, and virtually any other information that is ever gathered on individuals, and which formerly ended up on paper in filing cabinets, is now put into electronic databases. Companies are buying and selling that data, swapping it, and giving it to their affiliates. Numerous abuses have already occurred. We had a golden opportunity in this bill to put an end to those abuses. Instead, we have come up with weak, meaningless protections at the same time as we are allowing the creation of new financial service entities that will greatly expand the opportunities for abuse. We also believe that too much ground was given on the CRA issue. The CRA is being used to blackmail legitimate businesses; we ought to have insisted on the Senate-passed provisions that would have ended that blackmail. We support the removal of antiquated barriers between the banking, insurance, and securities industries, but not at any price. The privacy and CRA provisions in this bill make it unsupportable.